DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Office of Audit Services
REGION IV
61 Forsyth Street, Room 3T41
Atlanta, GA 30303-8909

Memorandum

Date: SEP 18 2001

From: Regional Inspector General
for Audit Services, Region IV

Subject: Supplemental Claim Submitted by
Connecticut General Life Insurance Company

To: Sara Smalley, Acting Director
Division of Accounting, CMS

Attached is our final audit report on the results of our review of the allowability of costs the Connecticut General Life Insurance Company (CGLIC) included in its supplemental claim dated August 27, 1999. The objective of our review was to determine the allowability of the $16,177,473 claimed by CGLIC and to provide the Centers for Medicare and Medicaid Services (CMS) audit assistance in negotiating a settlement of the claim.

I wish to express my appreciation to you for the opportunity to serve CMS in this matter. I would also like to express our appreciation for the cooperation we received from CMS during the review. I believe the close cooperation between our offices helped to ensure the favorable results from the negotiations.

If we can be of any further assistance regarding CGLIC, please contact me at (404) 562-7750.

Charles J. Curtis

cc:
George M. Reeb, AIGA/CMS

Department of Health and Human Services

OFFICE OF INSPECTOR GENERAL

REVIEW OF SUPPLEMENTAL CLAIM SUBMITTED BY THE CONNECTICUT GENERAL LIFE INSURANCE COMPANY (CGLIC)

SEPTEMBER 2001
A-04-01-01013

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Date: SEP 18, 2001

From: Regional Inspector General
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Subject: Supplemental Claim Submitted by Connecticut General Life Insurance Company (CIN A-04-01-01013)

To: Sara Smalley, Acting Director
Division of Accounting, CMS

This memorandum report summarizes the results of the assistance our office provided to the Centers for Medicare and Medicaid Services (CMS) in determining the allowability of the $16,177,473 of costs claimed by Connecticut General Life Insurance Company (CGLIC) in its supplemental claim dated August 27, 1999. The supplemental claim included electronic data processing costs totaling $12,612,691; return on investment on indirect assets totaling $3,417,483; and distributed technology services totaling $147,299. The review was requested by the CMS Contracting Officer.

OBJECTIVE

The objective of our review was to determine the allowability of the supplemental costs claimed by CGLIC for the period October 1, 1989 through September 30, 1997; Federal Fiscal Years (FY) 1990 through 1997.

SUMMARY

Our review led to a Negotiated Settlement Agreement between CMS and CGLIC, executed on August 2, 2001, that reduced the claimed costs by $15,081,097. The remaining $1,096,376 represented a negotiated settlement of costs that CMS will reimburse CGLIC under the terms of the Medicare contracts.

BACKGROUND

By letter dated August 27, 1999; CGLIC submitted a claim under its Medicare contract for $16,177,473 of additional costs for the period October 1, 1989 through September 30, 1997. The CMS' Contracting Officer requested that our office review the allowability of the additional costs to assist them in evaluating the appropriateness of the claim.

SCOPE

To accomplish our objective, we held discussions with CGLIC officials, reviewed the records provided by CGLIC to support the allowability of the additional costs, reviewed applicable laws and regulations, and performed other auditing procedures as were considered necessary in the circumstances.

We also provided a presentation to the CMS Contracting Officer and other CMS officials on November 15, 1999 and assisted the attorneys of the HHS Office of General Council (OGC), who negotiated the settlement on behalf of CMS.

Our review did not include a study and evaluation of CGLIC's internal accounting controls, because the objective of our review was accomplished through substantive testing.

Our audit work was performed in the Office of Audit Services Regional Office, Atlanta, Georgia from September 1999 through July 2001.

Our review complied with the generally accepted government auditing standards that were considered necessary to accomplish our audit objective.

We did not hold entrance or exit conferences with CGLIC as no on site field work was performed and because the results of our review were intended to assist CMS officials and the Office of General Council attorneys in negotiations with CGLIC on the amount, if any, to be paid on the supplemental claim.

RESULTS OF REVIEW

Our review led to a Negotiated Settlement Agreement between CMS and CGLIC, executed on August 2, 2001, which reduced the $16,177,473 claimed by $15,081,097. The remaining $1,096,376 represented a negotiated settlement of costs that CMS will reimburse CGLIC under the terms of the Medicare contracts. The $15,081,097 reduction consisted of unallowable electronic data processing costs totaling $12,612,691; return on investment in indirect costs totaling $2,417,483; and distributed technology services totaling $50,923.

Electronic Data Processing

The supplemental claim included $12,612,691 of electronic data processing (EDP) costs for the period October 1, 1989 through September 30, 1997. The additional EDP costs were based on CGLIC's application of a revised methodology for charging EDP costs to the Medicare contract during that period.

Our review disclosed that CGLIC's claim for additional EDP costs was based on a deviation from its historical practice of charging EDP costs to all its customers based on "class of machines" to that of retroactively charging EDP costs on an "individual machine" basis to only the Medicare contract. However, Appendix B, Article II., A. Consistency in Estimating, Accumulating and Reporting Costs of the Medicare contract states:

> "Each contractor's practices used in estimating costs for proposal purposes shall be consistent with cost accounting practices used by him in accumulating and reporting costs. Consistency in the application of cost accounting practices is necessary to enhance the likelihood that comparable transactions are treated alike."

This contractual requirement is intended to provide the Contracting Officer (CO) assurance that estimated costs will approximate actual costs to be incurred under the contract. It also enables the CO to effectively administer Medicare program funds with the knowledge that contract costs are uniformly and consistently proposed, budgeted and reported both within the contract performance period as well as future contract periods.

The CGLIC has administered the Medicare program under contract with CMS since October 1, 1989. From that date through September 20, 1995, CGLIC chose to consistently estimate, accumulate, and report EDP costs by class of machines rather than on an individual machine basis. As a result, CGLIC's budget proposals and reports of financial activities to CMS relative to EDP costs were consistently based on the class of machines methodology for the entire 8-year period of contract performance.

In effect, CGLIC's supplemental claim for EDP costs suggests that CMS should now summarily waive the above cited "Consistency" requirement of the Medicare contract and allow CGLIC to be reimbursed on the basis of an accounting methodology which it had not employed during any portion of the contract period in question.

Appendix B, Article II., B. Consistency in Allocating Costs for the Same Purpose of the Medicare contract states:

> "The contractor shall be required to provide assurance that each type of cost is allocated only once and only on one basis to the contract or other cost objective."

The CGLIC consistently chose to allocate the costs of EDP equipment to all of its lines of business (LOB) based on class of machines. For the Medicare program only, CGLIC's supplemental claim deviates from its well established and chosen "class of machines" methodology to apply the "individual machine" allocation methodology to only its Medicare contract. All other LOBs would continue to be charged using CGLIC's standard costing methodology. In our opinion, application of the revised methodology to the Medicare contract would result in more than one basis for allocating EDP costs and constitute clear violation of the cited contractual requirement.

Based on our review, we recommended to CMS that it not reimburse CGLIC for the $12,612,691 of EDP costs included in the supplemental claim. The CMS Contracting Officer cited our position on EDP costs in his denial letter to CGLIC dated March 13, 2000.

Return on Investment on Indirect Assets

The supplemental claim included $3,417,483 for return on investment (ROI) on indirect assets for the period October 1, 1989 through September 30, 1997. The additional ROI costs were based on CGLIC's application of ROI rates to investments in indirect assets for which ROI costs had not previously been claimed.

Our review disclosed that CGLIC: (1) had claimed ROI on assets that did not benefit the Medicare contract; (2) claimed ROI on assets for which no supporting documentation was available; and (3) incorrectly allocated ROI to Medicare.

ROI on Assets Not Benefiting Medicare: Appendix B, X., Article A, provides that CGLIC may claim ROI:

> "To the extent that land, tangible depreciable assets such as buildings, equipment and leasehold improvements, owned by the contractor are used for Medicare purposes…"

This contractual requirement provided the contractor a financial return on resources and assets used for Medicare purposes. However, a significant portion of the assets was used for functions that did not provide any benefit to Medicare.

For example, the supplemental claim included ROI on the indirect assets used by CHC Legal, CIGNA Health Care Affiliates, Business Development and Marketing, and CHC National Sales and Delivery Network. However, Medicare did not benefit from these functions. As a result, the amount of additional ROI included in the supplemental claim for these functions was not allowable under the terms of the Medicare contract.

ROI on Assets Without Supporting Records: Our review disclosed that CGLIC had included indirect assets for FYs 1990 and 1991 for which no records were available. Accordingly, the $677,397 ROI included in the supplemental claim for these 2 years was unallowable.

Incorrect Allocation of ROI to Medicare: CIGNA Health Care (CHC) managed the Medicare contract for CGLIC. In turn, CHC was one of several CIGNA divisions. Both CIGNA and CHC provided administrative services to the Medicare contract. Therefore, a portion of the administrative services incurred by CIGNA and CHC were allocable to the Medicare contract and were eligible for reimbursement under the terms of the contract.

The CGLIC used "managed expenses" as the basis for allocating a portion of administrative services incurred by CIGNA and CHC to the Medicare contract.

The CIGNA allocated a portion of its administrative expenses to the Medicare contract based on the relationship of total direct Medicare expenses to total direct CIGNA expenses. For example, for 1997, Medicare's direct costs constituted 1.47 percent of CIGNA's total direct expenses. Thus, CIGNA allocated 1.47 percent of its administrative expenses to the Medicare contract.

The CHC used a similar methodology for allocating a portion of its administrative expenses to the Medicare contract. Its allocation was based on the relationship of total direct Medicare expenses to total direct CHC expenses. For example, for 1997, Medicare's direct costs constituted 3.32 percent of CHC's total direct expenses. Thus, CHC allocated 3.32 percent of its administrative expenses to the Medicare contract.

In these circumstances, the amount of administrative expenses (including ROI) to be allocated to the Medicare contract would vary significantly depending upon whether the cost was classified as incurred by CIGNA or by CHC – 1.47 percent vs. 3.32 percent in 1997. Therefore, it was incumbent on CGLIC to ensure that assets were properly classified as CIGNA or as CHC when computing the ROI to be included in the supplemental claim. However, this was not always accomplished by CGLIC.

For example, CHC's headquarters are located in the "Bloomfield Campus" located in Bloomfield, Connecticut. The CGLIC had not previously claimed ROI on the indirect assets that constituted the Bloomfield Campus. Therefore, CGLIC included ROI on the Bloomfield Campus in the supplemental claim. As CGLIC assumed that the Bloomfield Campus was used only by CHC, for 1997, CGLIC allocated 3.32 percent of the ROI for the Bloomfield Campus to the Medicare contract. However, our review disclosed that several of the functions housed in the Bloomfield Campus should have been classified as CIGNA functions. Thus, only 1.47 percent of the ROI claimed on the assets used by these functions should have been allocated to the Medicare contract vs. the 3.32 percent actually claimed. As a result, the ROI included in the supplemental claim exceeded the amount actually allocable to the Medicare contract.

Based on the results of our review, CMS negotiated with CGLIC a payment of $1,000,000 in full payment of the $3,417,483 of ROI included in the supplemental claim.

Distributed Technology Services

The supplemental claim included $147,299 for distributed technology services. We did not review these costs due to their insignificant amount. The Settlement Agreement provides that CMS will reimburse CGLIC for $96,376 for these costs, and that the reimbursement is subject to possible future audit and adjustment.

If you have any questions regarding this matter, please contact me at (404) 562-7750.

Charles J. Curtis

cc:
George M. Reeb, AIGA/CMS